

MINUTES

BOARD OF TRUSTEES OF THE PUBLIC EMPLOYEES' RETIREMENT FUND 143 West Market Street, Suite 500 Indianapolis, IN 46204

May 10, 2002

Trustees Present

Jonathan Birge, Chair
Richard Doermer, Vice Chair
Teresa Ghilarducci (by telephone)
Steven Miller
Nancy Turner

Others Present

Mike Gery, Executive Assistant to the Governor
Diana Hamilton, Special Liaison to the Governor for Public Finance
Richard Boggs, Burnley Associates
Stephanie Braming, William M. Mercer Investment Consulting
Micah Fannin, William M. Mercer Investment Consulting
Mary Beth Braitman, Ice Miller
Eric Swank, Ice Miller
Doug Todd, McCready & Keene, Inc.
Karen Franklin, National City Bank
E. William Butler, PERF Executive Director
Caroline Drum Bradley, PERF Internal Auditor
Diann Clift, PERF MIS Director
Joseph Duncan, PERF Investment Analyst
Patricia Gerrick, PERF Chief Investment Officer
Ed Gohmann, PERF Legal Counsel
Patrick Lane, PERF Communications Director
Doug Mills, PERF Chief Financial Officer
Jim Osborn, PERF Project Director
Kevin Scott, PERF Chief Benefits Officer
Lynda Duncan, Minute Writer

ITEMS MAILED TO THE BOARD PRIOR TO MEETING

- A. Agenda of May 10, 2002 Meeting
- B. Minutes:
 - ❑ April 12, 2002 Board of Trustees Meeting
 - ❑ February 8, 2003 and March 15, 2002 Investment Committee Meeting
- C. Reports, Summaries, Memorandums and/or Letters Concerning:
 - ❑ Municipality Employer Contribution Rates
 - ❑ Revised Actuarial Valuations
 - ❑ PERF Pension Plans – Funded Status
 - ❑ Line-of-Duty Death Determination Documentation
 - ❑ Member Service Reporting – Aging Charts
 - ❑ Compliance Reports (Burnley Associates)
 - ❑ Performance Reports (Mercer Investments Consulting, Inc.)
 - ❑ Alternative Investment Recommendations
 - ❑ Draft Audit and Budget Committee Charter
 - ❑ Actuarial Audit Recommendation
 - ❑ Year to Date Expenses Update

A quorum being present, the meeting was called to order.

1. PRESENTATION BY LINDSAY GOLDBERG & BESSEMER L.P. Robert Lindsay and Allen Goldberg provided a synopsis of the middle market buyout fund, which is targeted to raise \$2 billion. The focus is on family run businesses selling for lack of ample growth capital or estate planning purposes. The fund invests in private companies that are selected through a process of financial analysis, audit checks, benchmarking, etc. Their profits are achieved by building up the businesses and this is financed through a network of investors. They maintain an extensive network of investors, which is the primary source of transactions. They have their own network of law firms, accounting firms and state advisors. The typical investment size is between \$100 and \$200 million. Ninety percent of their investments are based in the United States, although they do have an affiliate in Germany. Their focus is on basic manufacturing, financial services, health care services, hospital management, and commodity-based manufacturing. Holding periods range between three to six years. Mr. Birge asked if they had any investments in Midwest companies, and he was advised that the firm was interested in the Midwest because of the number of family-owned businesses with manufacturing elements and the strong engineering and technical background of the region.
2. MINUTES APPROVAL

MOTION duly made and carried to approve the Minutes of the April 15, 2002 meeting of the Board of Trustees.

Proposed by: Steven Miller
Seconded by: Richard Doerner
Votes: 5 for, 0 against, 0 abstentions

3. DISCLOSURES

Mr. Doermer – Bank One stock ownership.

4. EXECUTIVE DIRECTOR'S REPORT.

- a. Nancy Turner's CETB Certification. Mr. Butler, on behalf of PERF Staff and other Board members, congratulated Ms. Turner on the successful completion of the Certificate of Achievement in Public Plan Policy in Employee Pensions sponsored by the International Foundation of Employee Benefit Plans.
- b. Municipality Employer Contribution Rates. Mr. Todd presented the municipality employer contribution rates. These rates have been based on new actuarial assumptions (and a change in a valuation program) which were effective July 1, 2001 and were developed with rounding rules applied. An addition had been made for super-funded plans (municipality plans that are actuarially funded in excess of 175%, e.g. Noble County). These superfunded plans, provided they meet the qualifications, have an employer contribution rate of 0%. An anomaly had been noted for two funds that should not have been treated as superfunded plans in last year's list of municipality employer contribution rates. This was attributed to units reporting their employee contributions late and as a result the PERF computer treated the active members of these units as being terminated. Letters had been sent to them to advise them that their contribution rate would be 0% for calendar year 2002 so the correct amount would have to be made-up in the last two quarters of the year. PERF will work with the employers concerned to rectify this error. None of the employers had a contribution rate of less than 1% except for the superfunded funds. It was noted that the funded status of these funds had fallen due to the decrease in their assets. The funded status of Noble County had dropped from 255% to 221%.

MOTION duly made and carried to adopt the final employer contribution rates as presented by McCready and Keene.

Proposed by: Richard Doermer
Seconded by: Teresa Ghilarducci
Votes: 5 for, 0 against, 0 abstentions

- c. Revised Actuarial Valuations. At the last Board meeting, the actuarial valuations for two of the plans had shown unrealized capital gains as zero, which was determined to be incorrect. Actuarial valuations for these two plans were revised to reflect a correction to unrealized capital gains and losses, as of July 1, 2001, as follows:

➤ Prosecuting Attorneys Retirement Fund (PARF).

Total Employer Annual Cost	\$ 906,543
Cost as Percentage of Anticipated Payroll	6.6%

MOTION duly made and carried to accept the revised actuarial valuation for the Prosecuting Attorneys Retirement Fund.

Proposed by: Richard Doermer
Seconded by: Steven Miller
Votes: 5 for, 0 against, 0 abstentions

➤ Judges' Retirement System:

Contribution Based on 20 Year funding from July 1, 1997	\$12,365,532
Contribution Based on 30 Year funding from July 1, 1997	\$10,865,928
Suggested minimum contribution (40 year funding from July 1, 1997)	\$10,320,300

MOTION duly made and carried to accept the revised figures presented by McCready and Keene, Inc., for the actuarial valuations for the Judges' Retirement System.

Proposed by: Teresa Ghilarducci
Seconded by: Steven Miller
Votes: 5 for, 0 against, 0 abstentions

Mr. Doermer noted that the revised figures were in effect the same figures adjusted by spreading unrealized losses over a four-year period. Originally the loss had been fully recognized in one year.

- Defined Benefit Plans Administered by PERF. At the request of the Board, Mr. Todd provided figures for the consolidated unfunded liability for PERF's six retirement plans. In his report, Mr. Todd included the annuity savings account figures in the funded status for PERF. The actuarial status of PERF as at July 1, 2001 was 105%. For the previous year, this figure was 107.4%. The fall was attributed to the decrease in assets value. The 1977 Police Officers' and Firefighters' Pension and Disability Fund had remained virtually the same (last year 92.2% compared to 92.0% for 2001). The Judges Pension Plan had improved slightly, increasing to 61.0% from 56.9%. The Conservation Enforcement Officers' and Excise Police Fund had dropped slightly from 74.3% to 71%. Figures for the PARF had slipped significantly, from 70.2% to 54.2%, due to a substantial increase in liability as a result of an increase in their benefit formula. There had been a slight improvement in the Legislators' Defined Benefit Fund that increased from 83.6% to 84.7%. For the entire fund, the actuarial funded status had noted a slight decrease falling from 103.8% to 101.9%. No action was recommended at this time.

- d. Call Center Manager. Mr. Lane noted that the training program for the Call Center Staff was on going. The hardware had been installed and the start-up date was scheduled for May 19, 2002. The Staff had already undergone four weeks of in-depth training, although it was acknowledged that it was difficult to cover the complexity of PERF's operations in such a short time.
5. INFORMATION TECHNOLOGY UPDATE. Ms. Clift advised that the SIRIS Stage II "rollout" had been implemented successfully on April 24, 2002. The Benefits Staff training on the new procedures was on going. The first payroll run had been accomplished on May 6, 2002. Approximately 30 issues had been identified for resolution. The Board congratulated Ms. Clift on the successful implementation of this project.
6. LEGAL ISSUES.
- a. Amendment to PERF's Administrative Rules. Mr. Gohmann noted a legal requirement to amend PERF's administrative rules in order to reflect recent changes made in federal and state laws (EGTRRA and SB59). The Board was required to authorize the commencement of the amendment process in order to adopt new rules.
- MOTION** duly made and carried to approve commencement of procedures to amend PERF's administrative rules to comply with legislative and other changes.
- Proposed by: Steven Miller*
Seconded by: Nancy Turner
Votes: 5 for, 0 against, 0 abstentions
- b. Disability Hearings. Mr. Gohmann noted that several 1977 Policeman and Firefighter Fund disability hearings were in process.
7. 1977 FUND POLICE OFFICERS' AND FIREFIGHTERS' FUND. Mr. Gohmann provided highlights of the Advisory Committee meeting held on April 22, 2002.

- The Advisory Committee had recommended approval of a line-of-duty death benefit in the case of Daniel Edenfeld, a deputy working for Allen County Sheriff's Department. Although at the time of the incident, Mr. Edenfeld had been working at the Allen County War Memorial, the Advisory Committee had recommended to approve the claim based on the logic that even though he was off-duty, he was engaged in enforcing the law because he had been making an arrest, and that his death had been related to the arrest he had made that night.

MOTION duly made and carried to approve the award of the Line-of-Duty death benefit in the case of Mr. Daniel Edenfeld, former Allen County Public Safety Officer.

Proposed by: Teresa Ghilarducci
Seconded by: Steven Miller
Votes: 5 for, 0 against, 0 abstentions

Mr. Miller asked if there were guidelines for such line-of-duty death determinations. Mr. Gohmann advised that there had been some precedents when individual had been called to enforce the law while off-duty and had been awarded the benefit. The death had to be the direct result of a personal injury or illness that is related to controlling or reducing a crime or enforcing criminal law. It was noted that each situation is unique and each determination should be made with regard to the intention of the statute.

- Deferred Retirement Option Plan (DROP) Seminars. This plan had engendered considerable interest among the members of the 1977 Fund, and a series of seminars to educate members on benefits and implications of the program were planned in June and July in various locations throughout Indiana. A FAQ had been prepared for the DROP seminars and had been posted on the PERF web site. The seminars will start on May 17, at the Fire Fighters' Statewide Conference.

8. BENEFITS ADMINISTRATION. The Benefits Administration Committee meeting had been combined with the Board meeting. Subjects addressed included:

- Uninterrupted Benefits. The goal of this initiative would be to provide retirees with uninterrupted benefits by paying an estimated benefit (85% of the estimated pension). This would not include the ASA balance. The process would involve three stages:
 - Preliminary Benefit. Referred to in the statute as the "estimated" benefit. This is where the applications are received and scanned and a preliminary check is issued.
 - Estimated Benefit. A report is received from the employer detailing the last day and wages of the retiring member, and advising of the intention to send the next quarters' contributions.
 - Final Benefit. A member officially becomes a 'retiree' in the quarter in which the actual contribution is received from the employer for that employee.
- When a member retires, there are several options concerning their ASA balance (amortization, survivor lifetime or time-limited benefit, lump sum payment, roll over, etc.). Ms. Ghilarducci asked for a breakdown on options selected by PERF's members, viz. how many elect to cash-out or rollover.
- Challenges to Implementation of Estimated Benefit within 30 Days.
 - SIRIS II has just been implemented and the staff needs time to become familiar with the new processes.

- Counseling sessions will be required to educate members regarding tax ramifications and their expectations with regard to the amount of the estimated check. The 'retiree' will only receive 85% of the defined benefit and not the ASA portion. This will mean that the check will be considerably less than most members anticipate
 - Additional payroll cycles. Currently, PERF has a monthly payroll cycle (15th of each month). An application must be processed 1.5 weeks prior to that deadline, giving approximately 2.5 weeks of real processing time before the check can be issued. SIRIS is not configured for an additional check run and it would take time to reconfigure the system. The Accounting Department and the Benefits Department would require some reorganization in order to handle the additional work involved in carrying out an additional check run.
 - Mr. Miller asked if PERF's major employers were informed about the estimated check initiative. Mr. Lane advised that this subject would be addressed at the next Employee Advisory Group meeting in July/August. It was considered imprudent to announce this initiative at this stage until PERF was confident that it could be implemented. Legislation was already in place to permit payment of estimated benefits. Mr. Birge noted that one of the issues would be the amount of manpower this initiative would require and how to procure this.
- Processing of Backlogs. It was noted that processing time periods continued to decrease.

9. INVESTMENTS. Steven Miller provided a summary of the Investments Committee Meeting held that morning.

a. Manager Searches.

- ❑ It was anticipated that the funding of new managers hired for Small and Mid Cap would be accomplished in October 2002.
- ❑ A search was in process for Mid Cap Value Managers with the aim of holding the final interviews before the next Board Meeting in June.

b. Teachers' Retirement Fund (TRF) Fiduciary Audit Report. Mr. Miller advised that an operational audit on TRF had been completed and was being reviewed for aspects that might relate to PERF. The audit had addressed governance, investment fees and custodial issues. Mr. Miller noted that it might be of benefit for the whole Board to review the findings of the report. The report included recommendations for a consolidated policy of governance, a Board education policy, and the addition of a Board ethics policy. It was noted that an ethics policy already existed for the PERF Board. Also addressed were investment operations and measurement of investment

performance. It was noted that PERF's investment performance information is gathered from several sources. Ms. Gerrick expressed concern that assets were priced by different pricing sources that gave rise to different valuations with a wide discrepancy between number. She stressed the importance of receiving integrated data that was reliable and complete. This could not be achieved with PERF's current custodial structure. Discussion followed on PERF's current custodial arrangements. Ms. Braming noted the Mercer had a database for custodial banks throughout the country, which benchmarked best practices. PERF's current structure does not meet industry standards for organizations of similar size and complexity. Ms. Braming noted that Mercer surveys custody providers annually. Mr. Doermer asked how many institutions or organizations would meet industry standards. Ms. Braming advised that there were probably six "tier one" custodial organizations (with primary focus on custody). A full benchmarking report was completed for PERF and presented to the Investment Committee. A fund of PERF's size and complexity (accounts, individual accounts, international securities, FX, and securities lending) requires a very high service level and a huge investment in technology. The Investment Committee will continue to examine this issue.

- c. PERF's Exposure to Worldcom. The Board was informed that this company's stock had been downgraded to junk status. The total cost of these securities held through PERF's portfolio had been \$65.4 million, but the current market value had fallen to \$15.6 million with losses spread across several managers. The major portions were in the index fund BGI, with approximately \$12 million spread across several fixed income accounts (Taplin holds \$10 Million). The advice at present from the managers was to keep the shares. Mr. Birge asked if PERF had any thresholds for fixed income manager investments. He was advised the PERF had guidelines for the duration of the portfolio, but none on the maturity of a single issue.
- d. Resolution from Indiana Institutional Investors. Mr. Miller advised that at the last meeting of the Indiana Institutional Investors, they had discussed investments in Indiana. As a result of discussion, they had produced a resolution of support on the part of PERF for Indiana Investments.

MOTION duly made and carried to adopt a resolution that the Indiana Public Employees Retirement Fund, by passing this resolution, intends to support Indiana new business initiatives. This was an expression of support for Indiana-based businesses.

Proposed by: Steven Miller
Seconded by: Nancy Turner
Votes: 5 for, 0 against, 0 abstentions

- e. Retention of Firms for Special Services. As part of the procedures for alternative investments, the Board had authorized the Investment staff to pursue certain due diligence functions that require the retention of special services, primarily law firms. Once PERF decides to invest in a particular venture, e.g. capital or buy-out fund,

there are certain procedures required prior to a final commitment. According to current procedures, the Board approves use of certain firms for these services and delegates to the staff the actual execution of the due diligence. The Investment staff met with several firms to discuss possibilities of representing PERF for services associated with alternative investments. These firms would be used in terms of setting up the agreements that are needed to permit alternative investments.

List of Firms.

Proskauer Rose LLP
Troutman
Jenkins and Gilchrist
Bakers and Daniel
Ice Miller

MOTION duly made and carried to approve the firms as listed above, discussed as The initial group of firms that would be eligible for use by the Investment Committee for specific uses.

Proposed by: Steven Miller
Seconded by: Richard Doermer
Votes: 5 for, 0 against, 0 abstentions

- f. Investment Policy Compliance Report – March Quarter 2002: Mr. Boggs of Burnley Associates advised that all Investment Managers appeared to be following the investment styles for which they were hired and no significant violations of their guidelines were detected.
- Sector Weighting. There was a variety of manager performances in sector weighting. Many managers were more heavily concentrated in corporates and asset-backed, mortgages, etc. All were more or less compliance. It was noted that all figures are pre-Worldcom. With regard to concentration, duration and standard deviations, none were outside the band. Black Rock was below minimum. Adelphia had been downgraded to CCC.
 - Security Lending. The generation of Security Lending Income held steady during the first quarter. Revenues received by PERF for the previous calendar year were \$3.75 million. Security Lending receipts by PERF continued to offset approximately 27% of investment manager and custody fees. There were no significant violations in cash-collateral portfolio activities.
 - Trading and Brokerage. Commissions averaged 2 cents per share during the past quarter. Commission rates were within the acceptable ranges for large institutional portfolios.

- Proxy Voting. This was delegated to the individual investment managers, each of whom decides how to vote in the economic best interests of the Fund and its beneficiaries. Mr. Doerner asked if PERF had guidelines with respect to the length of the maturity of fixed income investments. Mr. Boggs noted that this is captured by the duration guidelines, which is a function of the index. For active core bond managers, this cannot be more than 20% above or below. There is no specific maximum on maturity.
- g. State of Indiana Consolidated Retirement Investment Fund – First Quarter 2002.
- Ms. Braming of Mercer advised that figures for January and February 2002 were negative in the equity markets. The market had been very positive with strong economic growth in the first quarter; however this situation was reversed in April.
- Asset Allocation (Policy vs. Actual). The overweighting in the large caps and international represents an amount set aside for full funding of the global equity allocation.
 - The Fund had been underweight in mid-cap. The mid-cap growth manager had been approved and a search for the mid-cap value manager was in process. The fund was slightly overweighted in cash relative to the benchmark.
 - International Equity. The majority of assets were invested in active strategy.
 - Fixed Income. For the fixed income strategy, the majority was invested in active fixed income.
 - The total fund was up about 1.1% during the first quarter and outperformed the target reference index. Over the year, PERF had performed very well. This performance was largely due to the fact that the Fund was overweighted in the small cap equity. The global equity portfolios performed very well. Domestic equity was up by 1.7%. PERF was overweighted in the value portion of small caps and this helped DFA's performance. The value-oriented strategy worked well over the quarter. Domestic large cap equity was on target, and domestic small cap equity performed very well. For global equity, Brandes had outperformed for the first full quarter. Brandes said that they were closing their global equity portfolio to additional contributions from current investors because they were concerned about capacity. They will allow PERF to fund fully.
 - International equities were at 1.9%. The out performance was due largely to Capital Guardian. Significant dispersion was noted in performance calculations between the international managers and the consolidated account. The discrepancies could not be reconciled due to the use of multiple pricing sources within PERF.

- ASA Account. The total fund return for the one year was 4.9% which was below the guaranteed return of 8.3%. Since inception, the fund has been at 8.1% versus the guaranteed return of 8.4%. The total fund return had not met that guaranteed rate. This is set annually by the Board.
- The Pension Relief Fund was down to 2% for the quarter which was slightly below the index. For the one year, it was up 3.5%.
- The market had been very volatile with a great deal of accounting issues that continue to surface. Ms. Braming noted that market volatility would continue to be a factor.

10. FINANCIAL. Mr. Doermer advised that the Audit and Budget Committee had met on May 8, 2002. The following items were discussed:

- a. Evaluation of Actuarial Services. PERF had invited proposals from qualified firms to conduct an independent valuation of its actuarial services. Six firms had responded. The firms had been evaluated by the Mercer organization and a recommendation was made to select the Milliman Company to undertake this work subject to a reference check.

MOTION duly made and carried to approve the selection of Milliman to carry out the PERF's actuarial audit, as recommended by the Audit and Budget Committee.

Proposed by: Richard Doermer
Seconded by: Nancy Turner
Votes: 5 for, 0 against, 0 abstentions

- b. Charter and Mission of the Audit and Budget Committee. The Charter details with the organization of the Committee, membership qualifications, frequency of meetings, and dealing with internal and external auditors. The Committee had reviewed the draft and a few minor changes had been incorporated. The aim was to adopt the charter at the Board meeting in June.
- c. Internal Audit Charter. This lays out the function of the Internal Auditor and incorporates the standards and ethics of the Institute of Internal Auditing. Mr. Birge recommended that since this incorporated a number of changes, the Board should take and review the charter and refer any questions to the Committee members. Most of the changes made were to clarify the committee's responsibility in oversight. This will be discussed at the Audit and budget Committee meeting to be held on May 31, 2002.
- d. FY 03 Budget. Mr. Doermer noted that the staff had done an enormous amount of work in preparing the budget. The total projected budget, as recommended by PERF's management group, was \$33.2 million including capital projects. This represents a decrease from the FY02 revised budget of \$2.8 million. The total

recommended budget excluding capital projects was \$31.8 million representing a \$3.4 million increase over FY02. The increase was primarily due to investment manager fees (61% of the total). The increase in investment fees was approximately \$3.3 million. Mr. Mills noted that in producing the budget, each cost center had been prepared by department based on department head priorities for the next year and projected budget requirements. The Audit and Budget Committee had not yet passed the Budget.

- Mr. Doermer referred to a study carried out by CEM. This had included a comparison of expenditure per active member for several funds. PERF's performance had been low in all categories, with the cost per member at \$25 compared to the peer group average of approximately \$60. Mr. Doermer also noted that PERF was operating in a totally different climate than before and now employed 70 fulltime members and 37 temporary members.
 - The proposed budget had included the addition of 15 to 16 employees that had provoked some discussion due to the current financial situation of the State. Therefore, the Audit and Budget Committee had asked the PERF Staff to resubmit figures for review at the May 31, 2002 meeting. Mr. Mills noted that they had gone into the budget process with the objectives given by the Board and they had worked with department heads to come up with what was required. The intention had been to phase in new positions over the year. He considered that it had been important to put on the table what it would take to PERF's achieve objectives for improvements and to comply with recent legislative changes. The Staff would come back to the Audit and Budget Committee with priorities and to discuss the impact if PERF did not have the additional staff and the services that might be affected.
 - Mr. Doermer noted that the proposed budget figures reflected the objectives of the agency as a whole in various categories of activity, and this had been prepared in the context of making improvements. The Committee had considered that the realities of Indiana's current economic climate could not be ignored.
- e. FY02 Year to date Expenses Update. A year-to-date update of actual expenses in FY02 was provided.
11. EXECUTIVE SESSION. The Board met in Executive Session under IC 5-14-1.5-6.1(b)(2) (strategy with respect to litigation).
 12. NEXT MEETING. The next meeting of the Board will be held on Friday, June 14, 2002, at 1:00 p.m.
 13. ADJOURNMENT. There being no further business, the meeting was adjourned.